IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-157

UNITED HOUSING FOUNDATION, INC., *et al.*,

Petitioners,

—v.—

MILTON FORMAN and ELLEN FORMAN, *et al.*,

Respondents,

—and—

THE STATE OF NEW YORK and the
NEW YORK STATE HOUSING FINANCE AGENCY,

Additional Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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This brief is submitted in opposition to a petition for a writ of certiorari to review an interlocutory judgment of the United States Court of Appeals for the Second Circuit (C1-2)* remanding this action to the United States District Court for trial.

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* All "A," "B," and "C" references are to the pages of petitioners' appendices.

Questions Presented

1. Whether this case is ripe for review by this Court, where, before an answer has been interposed, the Court of Appeals has merely upheld federal jurisdiction, has made no findings on the merits and has remanded the case to the District Court for further proceedings.

2. Whether the public offering and sale of 1,312,000 shares of common stock to 15,372 purchasers for $32,800,000 cash constitutes the purchase and sale of a "security" within the meaning of the antifraud provisions of the federal securities laws.

Statement of the Case

This action arises out of the public solicitation of venture capital* for the construction of a mammoth cooperative housing development (A3). The respondents, purchasers of the common stock in issue, seek to represent 15,372 purchasers similarly situated, many of whom had invested their life savings in this enterprise (A3-4).

The project was constructed and financed under the New York State Mitchell-Lama Act, N.Y. Private Housing Finance Law §§ 1-59 (McKinney). Central to that statute is

* As the Court of Appeals observed, if the enterprise were to fail, respondents would have lost their entire investment (A18).

the mechanism for substantial* financing** of that housing by the New York State Housing Finance Agency.*** Private Housing Finance Law §§ 40-59.

Pursuant to the statutory scheme, the project had a sponsor, petitioner, United Housing Foundation (UHF),

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* By law, this financing was limited to a maximum percentage of the building costs, thereby mandating recourse to public solicitation for the balance of the venture capital. Private Housing Finance Law §§ 22(2), 25 and 26(1)(b). Accord, *Pine Grove Manor, Inc.* v. *Director*, 68 N.J. Super. 135, 171 A.2d 676 (App. Div. 1961) (cited at A18).

** Petitioners repeatedly refer to substantial state "subsidies" and to the cooperative housing project as a state "subsidized" and even a "social welfare program" (pages 2, 3, 5, 6, 11, 15). In point of fact this is palpably misleading. The Mitchell-Lama Act was designed in part to provide for "State aid, *without cash subsidy provisions,* for the development of housing projects by housing companies formed under this Act." Report of the Joint Legislative Committee on Housing and Multiple Dwellings (1955) (emphasis added), *reprinted in part* following N.Y. Private Housing Finance Law § 10 (McKinney), at 8. Indeed, the statute's very purpose was "to clarify the distinction between full-subsidized, low-income public housing programs administered by the State and its municipalities and housing programs undertaken by private entrepreneurs with only limited public assistance, in the form of mortgage loans, aid in land assembly or site acquisition or tax abatement for a limited period." Memorandum of the Joint Legislative Committee on Housing and Multiple Dwellings (1961), *reprinted in* New York State Legislative Annual—1961, at 244, 245.

*** Temporary and long term financing of such developments is undertaken by the New York State Housing Finance Agency through the sale of long term tax exempt bonds. The Housing Finance Agency is a separate corporation and its bonds are not full faith and credit bonds of the State of New York. Their tax exempt status results in a lower interest rate than would ordinary corporate bonds, which, in turn, produces an ultimate benefit to the stockholders and residents of the development.

This type of financing is very common in New York; *viz.*, New York State Dormitory Authority, New York State Job Development Authority. See also N.Y. Private Housing Finance Law §§ 44, 47 (McKinney Supp. 1973).

a corporation organized under the New York Membership Corporation Law (95a),* whose membership consists of trade unions and other organizations (A4). The general contractor and sales agent for the project was petitioner Community Services, Inc. (CSI), a corporation organized for profit under the New York Business Corporation Law and a wholly-owned subsidiary of UHF (A4). The co-operative housing corporation, Riverbay Corporation (Riverbay) whose common stock was sold to the respondents, owns the land and buildings constituting the project (A4). The individual petitioners herein, officers and directors of Riverbay, are also directors or officers, or both, of UHF and CSI (A5). Consequently, Riverbay is and was under the domination and control of UHF and CSI (A5).

Just as with every other large-scale public offering, the sale of Riverbay common stock was promoted by means of a prospectus, called in this instance an "Information Bulletin."** The Information Bulletin***

"[I]nvite[d] offers for shares of [Riverbay's] capital stock and/or other equity obligations for sale in units

* Page numbers appearing in parentheses followed by the letter "a" refer to pages in the printed appendix filed by respondents in the Court below. The reference at A4 to UHF's being incorporated in 1951 under the New York Not-For-Profit Corporation Law is an obvious, but immaterial, error as the statute was not enacted until 1969. L. 1969, ch. 1066, eff. Sept. 1, 1970.

** Since the petitioners moved to dismiss the amended complaint prior to answer, the allegations as to fraudulent statements and material omissions must be deemed true. See, e.g., *Walker Process Equip., Inc.* v. *Food Mach. & Chem. Corp.*, 382 U.S. 172, 174-75 (1965). Consequently, respondents shall not develop the facts thereof in this brief, but merely refer this Court to pages 8-19 of our principal brief in the Court of Appeals therefor.

*** There was also a revised Information Bulletin, but it had the identical language.

which will be allocated to the 15,500 [revised to 15,372] apartments of the development all in accordance with the terms of the subscription agreement" (178a).

The subscription agreement commenced:

"RIVERBAY CORPORATION

Subscription Agreement and Apartment Application

(Limited to Residents of the State of New York)

(1) I, (we) ....., hereinafter individually and collectively called the 'Subscriber,' hereby subscribe at the par value and principal amount thereof, to an aggregate of:

[Price of stock depending upon type of apartment chosen and calling upon subscriber to select the desired unit]

par value of Class B capital stock of RIVERBAY CORPORATION, . . . for the purpose of acquiring land and constructing and operating a housing project . . . ." (104a-105a).

Each subscriber agreed to purchase 18 shares of Riverbay stock at $25 par value per share for each room in the apartment, for an initial purchase price amounting to $450 per room (A5).*

Among the economic inducements set forth in the Information Bulletin to generate the respondents' interest in the purchase of Riverbay's common stock was (a) each purchaser's right to take income tax deductions for his pro

* The total purchase price was fixed at $3,856 per room (347a), but was raised to $5,737 per room (353a) as a result of the fraudulent conduct set forth in the amended complaint.

rata share of Riverbay's interest expense and real estate taxes (175a); (b) the purchaser's right to share in income from the leasing of retail establishments, office space, parking and other commercial enterprises (169a) and, (c) of at least equal importance, the opportunity to obtain desirable housing accommodations at a cost lower than the market price in New York City (166a) (A16-17).

The incidents of ownership of Riverbay common stock are, in most respects, identical to those obtaining with respect to stock of other real estate corporations. They are summarized in the decision of the Court of Appeals at A10-11. See also, *Pine Grove Manor, Inc.* v. *Director, supra.*

The Proceedings Below

Respondents filed their amended complaint in October, 1972. Prior to answer, petitioners moved, pursuant to Rule 12 FRCP, for a dismissal thereof for lack of federal jurisdiction (B4). The District Court dismissed the complaint on the ground that Riverbay stock was neither "stock" nor an "investment contract" within the meaning of § 3(a)(10) of the Securities Exchange Act (B4). The Court of Appeals unanimously reversed on both grounds (A20), upheld federal jurisdiction, and remanded the case to the District Court for further proceedings (A22, C2).

Reasons for Denial of the Petition

1. *The Case Is Not Yet Ripe for Review.*

On the petitioners' motion prior to answer, the United States District Court dismissed the amended complaint for "lack of subject matter jurisdiction" (B29). The United States Court of Appeals "[e]xpressing no opinion whatso-

ever on the merits," nevertheless "reversed" and "remanded . . . for further proceedings in accordance with [its] opinion . . . ." (A3, C2).

Consequently, the judgment sought to be reviewed is not final, but interlocutory and is therefore not yet ripe for review by this Court. *Brotherhood of Locomotive Firemen & Enginemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967); R. Robertson & F. Kirkham, Jurisdiction of the Supreme Court of the United States § 130, at 232-33 (2d ed. R. Wolfson & P. Kurland 1951); R. Stern & E. Gressman, Supreme Court Practice § 4.19, at 180 (4th ed. 1969). See also *Hamilton-Brown Shoe Co.* v. *Wolf Brothers & Co.*, 240 U.S. 251, 258 (1916); *Chicago & N.W. Ry.* v. *Osborne*, 146 U.S. 354, 355 (1892).

2. *There Is No Conflict Among the Circuits Which Would Require the Extraordinary Grant of Certiorari to Review an Interlocutory Judgment.*

Contrary to petitioners' assertion (pages 17-20), every Federal Court which has considered the question, whether stock in a real estate or other cooperative corporation is a "security" has held either directly or implicitly that it is a security. See *1050 Tenants Corp.* v. *Jakobson*, CCH Fed. Sec. L. Rep. ¶ 94,702 (2d Cir. July 8, 1974); *Ashton* v. *Thornton Realty Co.*, 346 F. Supp. 1294 (S.D.N.Y. 1972), *aff'd mem.*, 471 F.2d 647 (2d Cir. 1973); *Davenport* v. *United States*, 260 F.2d 591 (9th Cir. 1958), *cert. denied*, 359 U.S. 909 (1959); *Stockton* v. *Lucas*, 482 F.2d 979 (Temp. Emer. Ct. App. 1973); *Wallack* v. *Davis*, CCH Fed. Sec. L. Rep. ¶ 94,622 (S.D.N.Y. June 27, 1974).

The authorities cited by petitioners (pages 19 and 20) all deal with promissory notes given in commercial loan transactions, with the exception of *Vincent* v. *Moench*, 473 F.2d 430 (10th Cir. 1973), which deals only with the transfer

of a partnership interest. (*Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075 (7th Cir. 1972), *cert. denied*, 409 U.S. 1009 (1974) and *SEC* v. *Continental Commodities Corp.*, No. 73-2429 (5th Cir. July 17, 1974) both held the notes in issue to be securities.) Even so, it is absolutely clear from a reading of these cases that it is only those promissory notes which are given in short-term commercial loan transactions that are not deemed to be securities, as opposed to promissory notes which are sold for purposes of investment, and which are held to be securities. The complete inapplicability of the commercial promissory note cases to the instant situation involving the massive public solicitation of $32,800,000 of venture capital through the sale of common stock is too obvious to require extended comment. See also *Movielab, Inc.* v. *Berkey Photo, Inc.*, 452 F.2d 662 (2d Cir. 1971).

This case, therefore, presents no conflict with any other decision of a Circuit Court which would require resolution by this Court, especially upon a record in which the petitioners have not even joined issue with the amended complaint.

3. *The Court of Appeals Decision Below Follows This Court's Repeated Holdings.*

a. The Decision Follows This Court's Direction that the Securities Laws Be Broadly Construed so as to Give Effect to Their Salutary Purposes.

This Court has directed repeatedly that the securities laws are to be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes." *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151, *rehearing denied*, 407 U.S. 916 and 408 U.S. 931 (1972); *Superintendent of Insurance* v. *Bankers Life & Casualty*

Co., 404 U.S. 6, 12 (1971); *Tcherepnin* v. *Knight*, 389 U.S. 332, 338 (1967); *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963). The Court of Appeals, by upholding federal jurisdiction in this action alleging fraud in the sale of over one million shares of common stock to 15,372 purchasers for $32,800,000, has expressly followed that direction (A14).

b. The Decision Follows This Court's Holdings that "Stock" Is a Security as a Matter of Law.

This Court has construed the definitional sections of the Securities Laws on two occasions, first in *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), and again in *Tcherepnin* v. *Knight, supra.* In *Joiner,* this Court held:

> "In the Securities Act the term 'security' was defined to include by name or description many documents in which there is common trading for speculation or investment. *Some, such as* notes, bonds, and *stocks,* are pretty much standardized and *the name alone carries well settled meaning. . . . Instruments may be included within any of these definitions, as matter of law, if on their face they answer to the name or description.*" 320 U.S. 344, 351 (emphasis added).

This construction was reaffirmed in *Tcherepnin, supra* at 339. The Court of Appeals in this case quoted the aforementioned statement from *Joiner,* and concluded:

> "This language gives support to the proposition that if a given instrument is a share of stock 'on its face' it is literally within the ambit of the statute" (A12).

c. The Decision Follows This Court's Holdings Defining the Elements of an Investment Contract.

The Court of Appeals held that Riverbay stock was also an "'investment contract'" (A20). In so holding, the Court squarely applied the classic definition of an "investment contract" which this Court expressed in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) as follows:

> "In other words, an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party...." (A15).

Petitioners in challenging this aspect in the decision below argue only that the "profit" element is missing here (pages 20-23). In so doing, they "mechanically" (A15) and erroneously insist that "expectation of profit" encompasses solely the expectation of capital gain. Neither this Court nor any other court has ever so held. Quite to the contrary, the Court of Appeals correctly observed that this Court has made it clear that the term "profit" is to be applied with common sense and in practical usage to denote "economic inducement," *i.e.*, the expectation of economic benefit, citing *SEC* v. *C.M. Joiner Leasing Corp.*, *supra* at 352-53 and *SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967) (A15).

The identical analysis has been made by every court and commentator to consider the term "profit." See, e.g., *Davenport* v. *United States*, 260 F.2d 591 (9th Cir. 1958), *cert. denied*, 359 U.S. 909 (1959); *SEC* v. *American Foundation for Advanced Education*, 222 F. Supp. 828 (W.D. La. 1963); *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P.2d 906 (1961) (Traynor, J.); 1 L. Loss, Securi-

ties Regulation 492-93 (2d ed. 1961); Zammit, "Securities Law Aspects of Cooperative Housing," 169 N.Y.L.J. No. 5, at 1, col. 3 (January 8, 1973); Note, "Cooperative Housing Corporations and the Federal Securities Laws," 71 Colum. L. Rev. 118, 129-31 (1971); *State ex rel. Troy* v. *Lumbermen's Clinic,* 186 Wash. 384, 394-95, 58 P.2d 812, 816 (1936); *Pine Grove Manor, Inc.* v. *Director,* 68 N.J. Super. 135, 171 A.2d 676, 684 (App. Div. 1961); *Commonwealth* v. *2101 Cooperative, Inc.,* 408 Pa. 24, 183 A.2d 325, 334 (1962); *State ex rel. Russell* v. *Sweeney,* 153 Ohio St. 66, 91 N.E.2d 13, 16 (1950).

The economic inducements or benefits offered to purchasers of Riverbay stock were, as the Court of Appeals held, substantial and real. They included: (1) the opportunity to share in income from rental of stores, office space, parking and other commercial enterprises (a total of over $4,000,000 annual income),* (2) the right to deduct for income tax purposes a pro rata share of the mortgage interest and real estate taxes paid by Riverbay, and (3) a very real reduction of expense which the purchasers would otherwise incur for the rental of comparable housing accommodations (A16-17). It should be noted that the economic inducement for many stock investments is the tax shelter, loss carry over, depreciation or depletion allowance, or other tax advantages which are available under the Internal Revenue Code and not primarily for either capital gain or ordinary income purposes.

Petitioners argue alternatively that the antifraud provisions of the federal securities laws should not be applied with respect to the sale of Riverbay's common stock be-

* This income would be transmitted to respondents in the form of a reduced monthly carrying charge or as a dividend (A16). Cf. *U of F Students Cooperative, Inc.,* [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,347 (SEC 1971).

cause UHF, the promoter-sponsor of this gigantic financial venture, is not a profit-making enterprise and because the construction, operation and sale of the development is subject to state supervision (page 2).* Petitioners thus seek to use their professed "eleemosynary" intent to excuse fraudulent conduct, under the familiar but misguided hypothesis, that the end, if socially desirable, justifies the means employed. Those contentions were rejected emphatically by the Court of Appeals as being both immaterial to the application of the antifraud provisions of the securities laws and erroneous in fact at A18-19.

4. *The Decision Below Is Consistent with the Rules and Regulations of the SEC.*

Contrary to petitioners' contention (pages 24-26), there is absolutely no inconsistency between the decision below and the Rules and Regulations of the SEC. As the Court below held, the SEC by its Rule 235, 17 C.F.R. § 230.235, which exempted certain smaller housing cooperatives from *registration,* implicitly recognized that the stock of a cooperative housing corporation was a security (A14).**

Securities Act Release No. 5347 (January 4, 1973), [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,163, relied upon by petitioners (page 24), expressly applies only

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* At various places in the petition, UHF incorrectly describes itself as "a nonprofit foundation" and "a nonprofit corporation" (pages 4 and 6) (*vide, infra*). For judicial rejection of parallel reasoning, see *Pine Grove Manor, Inc.* v. *Director, supra; Commonwealth* v. *2101 Cooperative, Inc., supra; State ex rel. Russell* v. *Sweeney, supra.*

** It is axiomatic that an exemption from registration does not carry with it an exemption from the antifraud provisions of the federal securities laws. See, e.g., *Tcherepnin* v. *Knight,* 389 U.S. 332, 344 (1967); *Hill York Corp.* v. *American Int'l Franchises, Inc.,* 448 F.2d 680, 695 (5th Cir. 1971).

to "condominiums and other types of similar units." In fact, the release was issued to clarify the "uncertainty about when offerings of condominiums and other types of similar units may be considered to be offerings of securities" for purposes of registration, not fraud. There was no need to clarify the status of offerings of shares of cooperative real estate corporations, as opposed to condominium realty interests, because those offerings were already the subject of Rule 235. Indeed, that rule is not even mentioned in Release No. 5347. Petitioners' further contention that the Real Estate Advisory Committee to the SEC recommended that condominiums and cooperatives should be subject to the same rules (page 24) misses the mark. Even if that Committee did recommend that the SEC alter its view with respect to the registration of cooperatives' securities, the SEC did not accept that recommendation. To the contrary, the treatment of cooperative shares remains precisely as the Real Estate Advisory Report described it:

> "Occupancy interests in cooperative housing are currently viewed as 'securities', primarily because such interests are represented by 'stock'." Report of the Real Estate Advisory Committee to the Securities and Exchange Commission 90, n.26 (October 12, 1972).

There was no recommendation that cooperative shares be exempted from the antifraud provisions of the securities laws.

Consequently, there is no reason for petitioners' feigned concern (pages 15-16). The decision below did not have any "enormous" impact on the real estate industry or constitute a "substantial impediment" to government-sponsored housing. Ever since the adoption of Rule 235 in 1961,

it has been recognized that the SEC considered stock in cooperative realty corporations to be a security for purposes of registration.* The decision below makes no change in that rule and it creates no confusion. It merely announces in clear terms to real estate developers and state agencies that they should make complete and truthful disclosures to prospective purchasers in accord with federal standards of lawful conduct in connection with the solicitation of venture capital to construct residential housing. If that is the "enormous impact" of the decision below, it is long overdue.

CONCLUSION

For the reasons above set forth, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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* There are numerous reported requests for no-action letters on cooperative housing offerings. See, e.g., *Lynbrook Gardens Tenants Corp.*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,146 (SEC 1971); *Summit House Tenants Corp.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,611 (SEC 1972); cf. *U of F Students Cooperative, Inc.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,347 (SEC 1971).